

## STATE OVERSIGHT AGENCIES

LHC thus recommended that the Governor and legislature enact legislation requiring CADA to prepare a development plan that defines a broader array of alternatives for developing CADA property as a whole, blocks of CADA property, and individual parcels. This plan should identify the policy and fiscal impact of alternatives on the state, CADA, the City of Sacramento, and the Sacramento Housing and Redevelopment Authority, and provide a timeline for implementation. The development plan should be consistent with the land use plans and mixed-use principles outlined in the CAP; assess the feasibility of selling all or portions of the property directly to the private sector for development in accordance with the CAP and local zoning; and assess the revenue generated from each proposed alternative and provide for the revenue to be returned to the state general fund. Finally, the legislation should direct the Department of General Services to more aggressively pursue ways of integrating the CAP's mixed-use principles into proposed office development projects.

Further, LHC found that CADA cannot effectively manage the property in its care, partially because it lacks the information necessary to maximize the state's investment in the property. Accordingly, LHC recommended that, as a first step, CADA should develop baseline information about its properties. Minimally, this baseline should include a by-parcel assessment with original purchase price and a description of current improvements, existing zoning requirements, current revenue stream, and projected lifecycle for each building that CADA manages. On an annual basis, CADA should update by-parcel assessments. Additionally, CADA should calculate a rate of return

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on each parcel, a summary of maintenance costs and projected expenses and proposals for intended use, and a timeline for implementation. The information should be reported on an annual basis as part of a consolidated financial statement to the legislature, the Department of General Services, and the City of Sacramento. Additionally, LHC recommended that CADA identify long-term preventive maintenance needs for each of its buildings and include provisions for making those capital improvements.

### Biennial Report 1997–1998

Released in January 1999, this report chronicles LHC's activities during the 1997–1998 two-year legislative session. During this time, LHC released eight reports: *Caring for Our Children: Our Most Precious Investment*; *Review of Governor's Reorganization Plan for Regulatory Oversight of Managed Health Care in California*; *Consumer Protection: A Quality of Life Investment*; *Review of State's Efforts to Meet Year 2000 Computer Change*; *Beyond Bars: Correctional Reforms to Lower Prison Costs and Reduce Crime*; *Dollars and Sense: A Simple Approach to School Finance*; and *Enforcing Child Support: Parental Duty, Public Priority*.

Also during this period, LHC supported 81 pieces of legislation in nine different policy areas; in some cases, the bills were outgrowths of studies conducted by LHC. The Commission withdrew its support from fifteen of those bills when amendments made them no longer compatible with LHC recommendations. Of the remaining 66 bills, 37 passed both houses of the legislature. The Governor signed 25 of those measures, and vetoed twelve LHC-supported bills.

## Legislative Analyst's Office

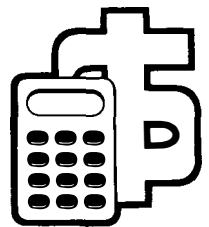
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The Legislative Analyst's Office (LAO) has been providing fiscal and policy advice to the Legislature for more than 55 years. It is known for its fiscal and programmatic expertise and nonpartisan analyses of the state's budget. Overseen by the 16-member bipartisan Joint Legislative Budget Committee (JLBC), LAO currently has a staff of 49 people. The analytical staff is divided into seven subject area groups of fiscal and policy experts.

The Office serves as the legislature's "eyes and ears" to ensure that the executive branch is implementing legislative policy in a cost-efficient and effective manner. The Office carries out this legislative oversight function by reviewing and analyzing the operations and finances of state government. Historically, one of the most important responsibilities of the

LAO has been to analyze the annual Governor's Budget and publish a detailed review at the end of February. This document, the *Analysis of the Budget Bill*, includes individual department reviews and recommendations for legislative action. A companion document, *Perspectives and Issues*, provides an overview of the state's fiscal picture and identifies some of the major policy issues confronting the legislature. These documents help set the agenda for the work of the legislature's fiscal committees in developing a state budget. LAO staff works with these committees throughout the budget process and provides public testimony on the Office's recommendations.

LAO also reviews requests by the administration to make changes to the budget after it is enacted; prepares special



reports on the state budget and topics of interest to the legislature; and prepares fiscal analyses of all proposed initiatives (prior to circulation) and measures that qualify for the statewide ballot.

## MAJOR PROJECTS

### Proposition 10

In *Proposition 10: How Does it Work? What Role Should the Legislature Play in its Implementation?* (January 1999), LAO summarized the key features of Proposition 10, an initiative enacted by the voters of California in the November 1998 election. Proposition 10 creates the California Children and Families First Program, which will fund early childhood development programs from revenues generated by increases in the state excise taxes on cigarettes and other tobacco products. The new program will be carried out by a new state commission which will adopt statewide guidelines for the program, and locally by county-appointed commissions which will adopt strategic plans to support and improve early childhood development programs. LAO estimated that Proposition 10 will result in increased revenues of about \$360 million in 1998–99 and about \$690 million in 1999–2000, with slightly declining amounts annually thereafter.

According to LAO, one of the key challenges related to the implementation of Proposition 10 is ensuring that the funds will be spent effectively. While the legislature has no direct control over the expenditure of Proposition 10 funds, LAO recommended that it take certain actions to encourage county commissions to spend their funds effectively. For example, LAO believes the legislature should establish a state-funded voluntary matching grant incentive program for Proposition 10 county commissions, which would fund early childhood programs that have been shown to be cost-effective and/or demonstration programs that are potentially cost-effective, based on existing research. LAO also suggested that the legislature adopt a joint resolution requesting the new state commission to (1) periodically review and disseminate the findings of early childhood development research to the county commissions, and review and comment on county expenditure plans for consistency with this body of research, and (2) review county plans to ensure that available federal funds are maximized and that local spending is integrated with existing programs.

### Tobacco Litigation Settlement

The attorneys general of most states—including California—and the major United States tobacco companies have agreed to settle more than 40 pending lawsuits brought by states against the tobacco industry. In exchange for dropping their lawsuits and agreeing not to sue in the future, the states

will receive billions of dollars in payments from the tobacco companies, and the companies will restrict their marketing activities and establish new efforts to curb tobacco consumption. In *The Tobacco Settlement: What Will It Mean for California?* (January 1999), LAO reviewed the settlement agreement and its potential impact on California, answered a number of questions about how the agreement will work, and raised a number of issues for consideration by the legislature.

The key features of the tobacco settlement require tobacco manufacturers to make payments to the states in perpetuity, with the payments totaling an estimated \$206 billion through 2025; create an industry-funded foundation whose primary purpose will be to develop an advertising and education program to counter tobacco use; place advertising re-

strictions on tobacco manufacturers, including bans on cartoons, targeting of youth, outdoor advertising, and apparel and merchandise with brand name logos; restrict tobacco companies to one brand name sponsorship per year; disband the Tobacco Institute and regulate new trade organizations;

prohibit tobacco manufacturers and their lobbyists from opposing proposed laws intended to limit youth access and use of tobacco products; and require tobacco companies to open a website which includes all documents produced in smoking and health-related lawsuits.

The settlement is projected to result in payments to California of \$25 billion through 2025. The amount will be split between the state and local governments (all 58 counties and four cities). There are no restrictions on the use of the money. However, according to LAO, it is uncertain how much money California will actually receive. The Governor's proposed 1999–2000 budget assumes the receipt of \$562 million in the budget year, which is equivalent to the first two payments to the state.

Although the settlement does not require any action by the legislature in order to take effect, LAO recommended that the legislature recognize the uncertainties surrounding the level of funds the state will receive, especially in the long run, and not dedicate the settlement monies to support specific new ongoing programs. LAO also suggested that the legislature consider the additional settlement revenues that will accrue to local government when considering future local government fiscal relief. Finally, LAO recommended that the legislature monitor new national anti-tobacco program in order to complement existing state efforts.

### Governor's Proposed 1999–2000 Budget

In *Overview of the 1999–2000 Governor's Budget* (January 1999), LAO summarized the main features of Governor Gray Davis' first proposed budget, along with key considerations facing the legislature as it develops its own version of the 1999–2000 budget. The Governor's budget proposes

total state spending of \$76.2 billion in 1999–2000 (excluding the expenditure of federal funds and selected bond funds), an increase of 4.1% from 1998–99. This total includes \$60.5 billion in general fund spending and \$15.7 billion in special funds spending.

Education funding accounts for over one-half of the Governor's total proposed budget.

Health and social services accounts for slightly more than one-fourth, while spending on youth and adult corrections accounts for about 7% of the total. All other programs—including resources, debt service, retirement costs, local tax relief, and general government—account for about 11% of the total.

LAO's key findings include the following:

- In general, the Governor's plan can be characterized as a "workload" budget, funding caseload and various inflationary adjustments.
- Most of the budget's new initiatives are related to K–12 education, where the Governor has included several proposals aimed at enhancing reading skills, improving teacher quality, and increasing school accountability.
- In order to eliminate a budget shortfall estimated to be in excess of \$2 billion, the plan includes several budget-balancing proposals and assumptions involving increased federal funds, asset sales, program cutbacks, and spending delays. LAO opined that many of the budget's assumptions, particularly those related to federal funds, are subject to significant risk.
- LAO believes that there is upside potential to the administration's revenue projections. This, in combination with lower Medi-Cal caseloads, could offset the risky expenditure assumptions included in the budget.
- If unanticipated revenues materialize during 1999, LAO believes that an increase in the budget reserve should be a high priority, given the volatility in the state's revenue stream and the risks related to many of the budget-balancing actions included in this spending plan.

## California's Tax Expenditure Programs

In a two-part report entitled *California's Tax Expenditure Programs* (February 1999), LAO reported on the status of California's many tax expenditure programs (TEPs), which include various tax exemptions, exclusions, deductions, credits, and other special tax provisions which affect the amount of revenues collected through the state's tax system. According to LAO, a periodic review of tax expenditure programs is important because, like direct expenditure programs, they constitute a commitment of resources. Direct expenditure programs are reviewed and funded during the course of the annual state budget process. However, the same process does not generally occur in the case of TEPs. Tax expenditure pro-

grams are different from direct expenditure programs in that they are provided through the tax system and their costs are funded from the reduction in state or local revenues stemming from their provisions, as opposed to through direct appropriations. As a consequence, it is important that TEPs be periodically reviewed through reports or other processes, to

ensure that they are effective and merit continued financial support from the taxpayers at large.

The report is divided into two parts. The first part, entitled "California's Tax Expenditure Programs: Overview," provides an overview of TEPs in the context of the state's overall tax system.

This overview consists of a discussion regarding alternative definitions of the tax base and how these relate to the notion of tax expenditures; a review of issues associated with the revenue estimation process for TEPs; a brief overview of the issue of tax incidence, including a discussion of the distributional impacts associated with taxes and TEPs; an identification of TEPs with a significant fiscal impact, along with estimates of revenue reductions from these programs individually and from TEPs in the aggregate, by general tax type; an identification of recently-enacted and recently eliminated TEPs, along with their estimated revenue effects; and a discussion of the use of TEPs as a policy tool and the effectiveness of tax expenditure reporting from a budgetary perspective.

Part Two, published as a separate document and entitled "California's Tax Expenditure Programs: Compendium of Individual Programs," presents an overview of each type of tax and detailed descriptions and commentary regarding individual TEPs, by program type. For each program, the following information is provided: the legal authorization; the revenue effect; a description of each TEP's basic provisions, and conditions under which they are applicable; the rationale for the TEP; the program's distributional effects, where appropriate; and comments that may assist the legislature or other readers in understanding a program's application or impact. These comments may relate, for example, to the TEP's legal history, its relationship to comparable federal programs, or empirical findings regarding the effectiveness of the TEP.

## CalWORKs Community Service

Community service employment is a key component of the California Work Opportunity and Responsibility to Kids (CalWORKs) program, enacted in AB 1542 (Ducheny) (Chapter 270, Statutes of 1997). Like its predecessor program (Aid to Families with Dependent Children), CalWORKs provides cash grants and welfare-to-work services to families whose incomes are not adequate to meet their basic needs. Under CalWORKs, able-bodied adult recipients (1) must meet "participation mandates" (see below), (2) are limited to five years of cash assistance, and (3) if no regular employment is found, must begin community service employment after no more than

24 months on aid. Welfare recipients who were receiving aid when CalWORKs was implemented will be reaching the community service employment requirement in 1999–2000.

In *CalWORKs Community Service: What Does It Mean for California?* (February 1999), LAO described how community service employment fits within the CalWORKs program, summarized recent research and evaluations of community service programs, examined the costs of the two major approaches to community service, and highlighted significant issues that the legislature will face in implementing and budgeting the community service phase of the CalWORKs program.

Community service employment is a key ingredient of the CalWORKs participation mandate. In general, the CalWORKs program requires that a parent must either find unsubsidized employment or participate in education/training activities for a specified number of hours per week. After 18 months, or at a county's option of 24 months, the parent must meet his/her participation mandate either through unsubsidized employment, community service, or a combination of the two. The weekly required hours of participation are as follows: (1) single parents must participate in approved work activities or training for a minimum of 26 hours per week in 1998–99 and 32 hours per week after July 1, 1999 (counties have an option to increase the requirement to 32 hours in 1998–99), and (2) one parent in any two-parent family must participate for 35 hours per week. According to LAO, most counties are still in the process of developing their community service plans; however, few plans have been finalized.

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"Community service" is defined by LAO as work performed by recipients of public assistance that otherwise would go undone by employees in the public, private, or private nonprofit sector. There are two broad approaches to community service: workfare and wage-based community service. Under workfare, recipients are required to participate in community service as a condition of receiving their public assistance grant. Under wage-based community service, the recipient's grant is used to fully or partially offset wages that are paid to the recipient. LAO noted an ongoing conflict between federal and state interpretations of the federal Fair Labor Standards Act (FLSA) with regard to whether welfare recipients engaged in community service are "employees" (such that they are entitled to minimum wage, workers' compensation, contributions to social security, and possibly unemployment insurance) or "trainees" (in which case they are entitled to none of the above). The U.S. Department of Labor appears to favor the "employee" approach, while the state Department of Social Services has opined that welfare recipients engaged in community service are generally "trainees." LAO questioned DSS' interpretation and warned the legislature that if the FLSA is applicable, it could have a significant effect on the weekly participation requirement for

participants (because the CalWORKs legislation limits total monthly compensation to the amount of the family's grant).

Although counties are responsible for designing and implementing community service programs, the state is responsible for program costs. The Governor's budget for 1999–2000 estimates that approximately 15,000 recipients will enter community service employment in January 2000, increasing to about 110,000 recipients by June 2000. The average monthly caseload for this six-month period is estimated to be about 61,000. These estimates assume that all counties extend the 18-month time limit to 24 months, and that all CalWORKs recipients who were on aid as of December 1997 had signed their welfare-to-work agreements by January 1, 1999. LAO generally agreed that most, if not all, counties will extend the time limit to 24 months, but believes the caseload projection is too high because it does not reflect any noncompliance by the recipients nor delays in signing welfare-to-work agreements; accordingly, LAO would reduce the administration's estimate by about one-third, to 40,000 average monthly cases.

The Governor's 1999–2000 budget proposal for community service employment is about \$20 million—this figure is based on an assumption of one hour of case management per month, with half of this time dedicated to creating the job slot. The budget also assumes that employers will absorb all supervisory costs. Child care and transportation costs are included for all CalWORKs recipients who need them, including community service participants.

Among other things, LAO's report found that although current law authorizes counties to adopt either the "workfare" (work-for-your-grant) or the wage-based (the recipient's grant is converted into wages) approach to community service employment, the Governor's proposed budget limits funding to the costs of the workfare approach (which essentially eliminates the private sector as employers). Although wage-based community service would provide more income for participating families, make them eligible for the federal earned income tax credit, and increase the number of potential employers, LAO further found that its cost-effectiveness is unknown.

LAO recommended that the cost-effectiveness of wage-based community service be evaluated in comparison to workfare by establishing a CalWORKs demonstration program. LAO also set forth three options for funding the incremental costs of the wage-based approach to community service, and recommended that counties be authorized to include private for-profit organizations as community service employers, thereby increasing the number of higher-quality community service job slots.

### **Child Support Enforcement**

The state's current child support enforcement program has as its primary purpose the collection of child support

payments for custodial parents and their children. The program, administered by county district attorneys, results in savings to the state because most of the collections made on behalf of families receiving aid under the CalWORKs program are used to offset the public costs of CalWORKs grants (see above).

In *The Child Support Enforcement Program From a Fiscal Perspective: How Can Performance Be Improved?* (April 1999), LAO noted that the state's child support enforcement system, as currently administered by county DAs, "has been the subject of considerable criticism for poor performance," and reported that there is a strong relationship between the amount of resources committed by the counties in administering the child support enforcement program and the amount of child support collected. LAO also found that the fiscal structure for funding the child support enforcement program in California gives counties an incentive to hold spending down to relatively low levels, even though increased spending is likely to be cost-beneficial from a statewide perspective due to the savings in CalWORKs grants. In LAO field visits, state and county administrators indicated that counties are reluctant to increase expenditures in the program once they achieve a "no net county cost" situation—that is, where their revenues from incentive payments and CalWORKs grant savings are sufficient to cover their county costs. As such, the counties often choose not to increase expenditures in the program even if they believe there is a chance of covering their additional costs.

In order to increase program spending, LAO offered two alternatives to move toward "fiscally optimal" investment levels in the child support enforcement program. The first option entails transfer of the administration of the child support enforcement program from DAs to the state, which would then have control over the allocation of program resources. LAO noted that several bills currently pending in the legislature call for state administration of the program.

LAO's second option is to establish a new incentive program; unlike the existing incentive mechanisms, however, this program would be specifically designed to address the tendency of the counties to be risk-averse with respect to increasing expenditures. Under this option, for any county that increases program expenditures by more than 5% (the statewide average increase between 1996–97 and 1997–98), the state would reimburse the county to cover any gap between the county's net revenues (incentive payments and CalWORKs grant savings) and net costs. Under LAO's proposal, expenditures required for the new statewide

automation system would be excluded. The Department of Social Services would conduct audits of county revenue and expenditure reports and would be responsible for determining the annual fiscal effects.

According to LAO, either option would lead to improvement in the performance of the state's child support enforcement program. State administration probably has greater potential to maximize the net fiscal benefit to the state, but could involve program disruptions such as staffing changes. The new incentive structure, conversely, probably would not result in optimal levels of spending but would be relatively easy to implement because it can be grafted onto the existing administrative structure.

## Other Reports

LAO also issued the following reports between January 1 and April 30, 1999: *A Special Session Guide to K-12 Reform*; *State Superfund Reauthorization: Expediting Hazardous Substance Site Cleanups*; *State Corporate Taxation of Sales to the Federal Government*; *Shifting Gears: Rethinking Property Tax Shift Relief*; *Year-Round Operation in Higher Education*; *Estimate of K-12 Average Daily Attendance Higher Than Expected: An Update on Federal Funds for Education*; and *Sliding-Scale COLAs to Equalize School District General Purpose Funding*. Additionally, LAO published the complete version of its *Analysis of the 1999–2000 Budget Bill*, including *The 1999–2000 Budget: Perspectives and Issues*.

## LEGISLATION

**AB 945 (Maldonado)**, as amended April 28, would—among other things—require LAO to conduct a study to determine what entity is fiscally responsible for providing specialized health care services to pupils with exceptional needs, and report the results of the study to the legislature and Governor on or before February 15, 2001. [A. Appr]

**AB 1566 (Lowenthal)**, as amended April 27, would authorize the Trustees of the California State University to establish a program under which each campus of the university, in collaboration with each local high school, would establish a pilot project mentoring program with the goal of providing experience, prior to student teaching, to students of the university who seek a career in teaching. Among other things, the bill would require LAO to evaluate the pilot project mentoring programs established pursuant to the bill as part of its analysis of the 2005–06 budget bill. [A. Appr]